Supreme Court, U.S.
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No. 93-1371

In The

Supreme Court of the United States

October Term, 1993

THOMAS FRANCIS GEPFRICH,

Petitioner,

vs.

MARJORIE LOIS GEPFRICH; JAMES FOX MILLER and MILLER & SCHWARTZ, P.A.,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Eleventh Circuit

RESPONDENT, DANIEL L. BAKST, TRUSTEE BRIEF IN OPPOSITION

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STATEMENT OF THE CASE

The Respondent, DANIEL L. BAKST, Trustee in bankruptcy, hereinafter referred to as Respondent/Trustee is filing a statement of the case to the extent deemed necessary to correct inaccuracies or omissions in the statement filed by the Petitioner, pursuant to Supreme Court Rule 15. Further, many portions of Petitioner's statement of the case contain improper argument.

A. Denial Of Discharge For Pre-bankruptcy Planning (Asset Conversions On The Eve Of Bankruptcy)

Petitioner does not set forth facts under this section, but argues his case.

B. Background; Origin Of The Equitable Distribution (Property Settlement) Debt To Mrs. Gepfrich

Respondent/Trustee has no comments concerning this section of the statement of the case.

C. Background; Origin Of Petitioner's $50,000.00 Certificate Of Deposit ("The CD")

When the Petitioner and Ronald Blum sold their Heritage stock, they each received a cash sum of $124,700.50. Out of these monies, they each placed $50,000.00 in a certificate of deposit, for a total sum of $100,000.00. The actual purchase price of the stock was much greater, due to the inclusion of contingent purchase price monies. In the stock purchase agreement dated March 18, 1987, the agreement refers to an additional purchase price equal to 50% of earnings, up to the sum of $240,000.00 for each

stockholder, after which the percentage then dropped to 40%.

D. Bankruptcy Filing To Avoid Jailing For Failure To Pay Equitable Distribution Debt: The Decision To Buy The Exempt Annuity

In the Circuit Court divorce proceeding, the State Court entered an Order on May 25, 1989, reciting the liquidation of assets by the Petitioner, and ordering him to pay the balance of the lump sum alimony in 26 days. The Petitioner testified at trial that he first considered the possibility of filing bankruptcy in late May 1989. At that time, the Petitioner was involved in the State Court divorce proceeding, and was faced with a contempt order for failure to pay lump sum alimony. The hearing scheduled on contempt was set for June 13, 1989 at 3:00 p.m. and the Petitioner feared that he would go to jail as a result of that contempt hearing. When the Petitioner met with Steve Eppel at Ambassador to release the pledge on the CD, he explained to Mr. Eppel that he was in the process of filing a bankruptcy because of his lengthy divorce and the problems that it caused with his financial position.

The Petitioner testified at trial that he was insolvent in May 1989, as his liabilities exceeded his assets and he was unable to pay his debts as they fell due. The Petitioner testified that he had been advised by bankruptcy counsel that he could possibly have his discharge denied if the purchase of the annuity was considered a transfer with the intent to hinder, delay or defraud creditors. The Petitioner stated that he was specifically trying to keep the money away from James Fox Miller, his former wife's

attorney and also his former wife due to the contempt matter coming up.

E. Florida's Liberality - Treating Insolvent Debtors' Asset Conversions To Exempt Property As Non-Fraudulent

Petitioner does not set forth facts under this section, but argues his case.

F. Purchase Of The Annuity 37 Minutes Before Bankruptcy; The Oral Binder For Annuity Coverage; The Cashier's Check

Sam Williams, the life insurance broker who prepared the application for the annuity, testified that Petitioner first called him within three to six weeks prior to June 13, 1989. The next contact with Petitioner after that time was in Sam Heller's office, Petitioner's bankruptcy counsel, on the day the bankruptcy was filed. Later on cross examination, Sam Williams recalled that Petitioner first contacted him in the last week of May 1989. Mr. Williams recalled that during the last week of May 1989, the Petitioner had mentioned that he had gone through a divorce and that there was a discussion about assets being excluded from creditors.

Douglas Fuerst testified at the first trial concerning the purchase of the annuity. Douglas Fuerst was a general agent or wholesaler for a variety of life insurance companies, including First Colony Life. Mr. Fuerst, who is not related or connected with First Colony except for being a general agent, was first contacted at 11:00 a.m. on June 13, 1989, concerning the issuance of the annuity policy. He was contacted by Sam Williams who indicated that he had a client who wanted to purchase an annuity policy

and that they wanted to have it issued that same day. Mr. Fuerst indicated that this was an unusual request and that he had never done that before. Mr. Fuerst called the company vice president, Linda Mayhu, for approval, who approved it based on the size of the annuity. As a result, the interest related back to the effective date of the policy, which was June 13, 1989.

Mr. Fuerst made it clear that he was not empowered by the company to accept money on behalf of First Colony, or to put it into his own bank account. The application for the annuity came into Douglas Fuerst's office around 1:00 or 1:30 p.m. while he was at lunch. He came back from lunch after an hour and faxed it to the insurance company. The date of the fax to First Colony was 3:11 p.m., after the filing of the bankruptcy proceeding at 2:27 p.m. that day. The application and the check were faxed to the home office at 3:11 p.m., and dropped in the Federal Express at 5:00 p.m. on June 13, 1989. The policy was physically issued on June 15, 1989.

The check that was sent to First Colony was a cashier's check from Ambassador to Thomas Gepfrich. That check was later endorsed by the Petitioner paid to the order of First Colony Life Insurance Company.

G. Litigation Regarding The Annuity Purchase

Respondent/Trustee has no comments concerning this section of the statement of the case.

H. Petitioner's Conflicting Testimony: Significant Or Not Significant?

There is a discrepancy in the Petitioner's testimony concerning the date that he first contacted Ambassador to

liquidate the certificate of deposit, which was used to buy the annuity. In an affidavit filed with the Bankruptcy Court in support of summary judgment, the Petitioner swore under oath that he first contacted Ambassador concerning the release of lien on the certificate of deposit in May 1989. At trial, the Petitioner testified that he did not discuss the early release of lien with Steve Eppel at Ambassador until June 8th or 9th, 1989. Steve Eppel testified that he saw Petitioner on June 8th or 9th, 1989. The matter of the conflicting affidavit was brought up during Steve Eppel's testimony at the first trial, in the presence of Petitioner. Petitioner's counsel later sought to correct the conflicting affidavit at the second trial on April 3, 1990.

I. Bankruptcy Court's Rulings On The Annuity Purchase

Petitioner does not set forth facts under this section, but argues his case.

J. Litigation Regarding The $25,000.00 In Post-petition Draws By Petitioner

Under the stock purchase agreement, the Petitioner treated all payments of the contingent purchase price as installment sale income and not wage income. This was set forth on the Petitioner's 1987 and 1988 income tax returns, introduced at trial. In both of those years, the Petitioner also received separate wages from Heritage, which were treated as wage income on the same income tax returns. The Petitioner further testified that he took money under the stock purchase agreement after the filing of the bankruptcy proceeding for the contingent purchase price, and spent those monies. Those funds

were not turned over to the Respondent/Trustee, although they were assets of the bankruptcy estate.

K. Bankruptcy Court's Rulings Regarding $25,000.00 In Post-petition Draws

Respondent/Trustee has no comments concerning this section of the statement of the case.

SUMMARY OF THE ARGUMENT

POINT I

The decision of the Eleventh Circuit Court of Appeals does not conflict with any prior decisions of the United States Supreme Court. The Court's decision did not affect the validity or scope of the Petitioner's exemptions under state law. Therefore, there is no conflict.

POINT II

The decision of the Eleventh Circuit Court of Appeals does not create a conflict on an issue of state law with any decision rendered by the Florida Supreme Court. The Eleventh Circuit properly affirmed the lower court's decision that the Petitioner's purchase of the annuity, under the circumstances surrounding it, constituted a fraudulent transfer pursuant to 11 U.S.C. § 548, and warranted denial of his discharge pursuant to 11 U.S.C. § 727(a)(2).

POINT III

There is no chaos or uncertainty among the Bankruptcy Courts, or in bankruptcy practice. In matters

involving fraudulent transfers or denial of discharge, the Bankruptcy Court sits as a trier of fact. It is clear under existing law that a debtor's discharge may be denied if non-exempt assets are transferred into exempt assets, where extrinsic evidence of the debtor's intent to defraud creditors exists.

POINT V

Decisions made by the trier of fact can only be set aside if there is a showing that the lower court clearly abused its discretion. In Bankruptcy Court trials, this is most often the Bankruptcy Judge that makes these decisions. The fact that Courts of Appeal rule in favor of the creditor in one instance, and the debtor in another, based on different sets of fact, does not create a conflict.

ARGUMENT

I. THE DECISION OF THE COURT OF APPEALS IS CONSISTENT WITH PRIOR DECISIONS OF THE SUPREME COURT

Respondent/Trustee agrees with Petitioner's statement that the validity and scope of a debtor's exemptions are controlled by state law. There is absolutely nothing in the Court of Appeals decision that conflicts with any decision by the United States Supreme Court. Nothing in the decision affects the exemption itself, only the transfer that created the exemption. Petitioner is attempting to create a conflict where none exists.

II. THE DECISION OF THE COURT OF APPEALS DOES NOT CONFLICT ON AN ISSUE OF STATE LAW WITH DECISIONS RENDERED BY THE FLORIDA SUPREME COURT

The Petitioner relies heavily on the case of *Lee vs. Bradley Fertilizer Company*, 33 So. 456 (Fla. 1903), a Florida Supreme Court case concerning dissolution of a partnership. In that case, the partnership dissolved, and certain partnership property became vested in title in the names of the individual partners, who then claimed them exempt under state exemption laws. The property in question was transferred on January 5, 1887. The creditor's bill attacking the transfer was filed on October 23, 1889, more than two and one-half years later. The Court found that the partners acted in good faith, and that the creditors had not obtained a lien by judgment or otherwise. This case also turned on the particular circumstances of dissolution of partnerships.

Petitioner also relies on the case of *Spach vs. Kleb*, 112 So.2d 21 (Fla. 3rd DCA 1959), a Florida Appellate Court decision that follows *Lee vs. Bradley*. This case also concerned the right of co-partners to severe their partnership relationship prior to the acquisition of liens by creditors, where the actions are taken in good faith. The Court denied the creditor's request for relief, stating that it was unaware of any law that gave a creditor an equitable lien upon the assets of a partnership.

Petitioner has cited cases concerning the right of a citizen of the State of Florida to own exempt property. While this is true as a general concept, it does not condone the situation where extrinsic fraud is present, and

where a debtor purchases exempt assets with the intent to hinder, delay and defraud his creditors. Exempt assets under applicable State law are also subject to being set aside if they were obtained by fraud or reprehensible conduct. *Clutter Construction Corporation vs. Clutter*, 173 So.2d 761 (Fla. 3rd DCA 1965). Therefore, Florida law does not stand for the proposition that citizens may retain all exempt assets, no matter how obtained, free and clear of the claims of all creditors. Debtors are always subject to the equally applicable rule of law that, where extrinsic fraud exists, a transfer into an exempt asset can be set aside.

Each case must rise or fall by the weight of the merits of that case. The facts and not necessarily the abstract statement of law, must rule the results of a proceeding to set aside a fraudulent transfer. *In re: Collins*, 19 B.R. 874 (M.D. Fla. 1982).

Under Florida law, when the legal effect of a conveyance is to delay, hinder or defraud creditors, it is fraud in law no matter what the actual intention may have been. *In re: Flanzbaum*, 10 B.R. 420 (S.D. Fla. 1981). It is appropriate to inquire into the circumstances surrounding a transfer, to examine whether a debtor has converted non-exempt property into exempt property with the specific intent to defraud his or her creditors. *In re: Schwarb*, 150 B.R. 470 (M.D. Fla. 1992); *In re: Strehlow*, 84 B.R. 241 (S.D. Fla. 1988); *In re: Marks*, 131 B.R. 220 (S.D. Fla. 1991), aff'd 976 F.2d 743 (11th Cir. 1992).

III. THERE IS NO CHAOS IN PRESENT BANKRUPTCY PRACTICE, AS SUFFICIENT GUIDELINES EXIST UNDER PRESENT LAW

Debtors are entitled to a fresh start, under existing law, but are not entitled to a head start. A list of prohibitions is contained in 11 U.S.C. § 727, as to what activities will prevent a debtor from obtaining a discharge. Included in that list are transfers made with the intent to hinder, delay or defraud creditors, within one year of filing a petition in bankruptcy.

In cases involving a debtor who has submitted himself to the jurisdiction of the Bankruptcy Court, the Bankruptcy Court sits as trier of fact. In determining issues of fraud, each case is weighed on its merits, and the trier fact must determine if fraud exists. Issues in law are not always black and white. Decisions made by a trier of fact can only be set aside if clearly erroneous.

The Petitioner's explanation that he relied on the advice of counsel concerning his right to own an annuity is no defense. A debtor who knows that the purpose of a transfer is to hinder or delay creditors does not rely in good faith upon the advice of counsel in negating an element of intent. *In re: Rice*, 109 B.R. 405 (E.D. Cal. 1989). The Petitioner admitted that he was warned of a possible challenge to discharge. It is also relevant that the Petitioner sustained a substantial interest penalty on the certificate of deposit by cashing it in early. In the case of *In re: Wallace*, 30 B.R. 5 (C.D. Ill. 1983), a debtor who cashed a certificate of deposit early at a substantial penalty and used the proceeds to purchase exempt assets, could not claim those assets as exempt. The Court in that case

found that there was extrinsic evidence of intent to defraud creditors.

Several courts have examined the legislative history, and have considered the argument raised by the Petitioner that the legislative history of 11 U.S.C. § 522 allows unfettered transfers of non-exempt assets into exempt assets prior to bankruptcy. In the case of *In re: Schwarb*, 150 B.R. 470 (M.D. Fla. 1992), the Court considered a situation where the debtors had sold non-exempt real property and mutual funds, and used the monies to buy exempt annuities, and pay off the mortgage on the exempt homestead, thirty (30) days before the filing of a bankruptcy proceeding. The debtors in that case raised the same basic defense the Petitioner is attempting to raise in this case. The Court thoroughly examined the Legislative History of § 522; S.Rep 95-989 and H.Rep 95-595. In addition to the Senate and House Reports, the Court reviewed the record of the hearings before the legislative committees. See, *Hearings on H.R. 31 and H.R. 32 before the Subcommittee on Civil and Constitutional Rights of the Committee on the Judiciary, 94th Cong., 2nd Sess. (1976).*

A full review of the hearing before the committee does not support a view of the legislative history as allowing uncontrolled pre-bankruptcy planning. In fact, a letter from Bankruptcy Judge Phelps, considered at the hearings, condemned the deliberate enlargement of exemptions out of the usual and customary manner of living in the contemplation of bankruptcy as a form of cheating which shocks one's conscience and brings the whole bankruptcy process into disrepute.

It is clear that a review of the complete legislative history of the Bankruptcy Code indicates that conversion of non-exempt property into exempt property should be permitted only within limits. Outright fraudulent bankruptcy planning that exceeds those limits should not be permitted. This view of the legislative history is also in accord with the language of the Bankruptcy Code, and with the general principals of equity. *In re: Schwarb, supra; In re: Spoor-Weston, Inc,* 139 B.R. 1009 (N.D.Okl. 1992).

IV. THE DECISION OF THE COURT OF APPEALS DOES NOT CONFLICT WITH DECISIONS OF OTHER COURT OF APPEALS, AND IS NOT UNDULY HARSH

The Circuit Courts of Appeals are consistent in holding that a debtor who converts non-exempt assets to exempt assets immediately before bankruptcy, with the intent to defraud creditors, must be denied a discharge in bankruptcy. *In re: Reed,* 700 F.2d 986 (5th Cir. 1983); *In re: Ford,* 773 F.2d 52 (4th Cir. 1985). The two Eighth Circuit cases cited by Petitioner are consistent in ruling that, absent extrinsic evidence of fraud, the mere conversion of non-exempt property to exempt property is not fraudulent as to creditors. *Norwest Bank Nebraska, N.A. v. Tveten,* 848 F.2d 871 (8th Cir. 1988); *Hanson v. First National Bank In Brookings,* 848 F.2d 866 (8th Cir. 1988). The difference between the decisions lies in the findings of fact by the respective Bankruptcy Courts. It is clear that factual findings by Bankruptcy Judges are to be accepted by the Court of Appeals unless clearly erroneous. *In re: Reed, supra.*

In the record before the Court, there was ample evidence of extrinsic fraud. In April 1989, the Petitioner was questioned under oath at a State Court proceeding in his divorce case as to the availability of funds in a certificate of deposit, which were subject to a "lien". On or about May 25, 1989, the Petitioner became aware that an order had been entered, directing him to pay all back lump sum alimony, or be faced with contempt. The hearing on contempt was scheduled for June 13, 1989 at 3:00 p.m. Petitioner's state court counsel urged him to hire bankruptcy counsel shortly after learning of the May 25, 1989 order.

Sometime between May 25, 1989 and June 9, 1989, the Petitioner contacted Ambassador to get the lien released against the certificate of deposit. Without any hesitation or delay, Ambassador granted this request, making available a cashier's check on the morning of June 13, 1989 in the approximate sum of $50,000.00. Petitioner then met the insurance agent at the office of his bankruptcy attorney, filled out the annuity application, endorsed the cashier's check, and filed bankruptcy at 2:27 p.m. that afternoon. Although the Respondent/Trustee maintains that the transfer was actually post petitioner, the alternative theory is that the transfer took place just before the bankruptcy proceeding, and that it was a fraudulent transfer pursuant to 11 U.S.C. § 548 and 11 U.S.C. § 727(a)(2). Under either scenario, Petitioner's discharge should be denied for making a fraudulent transfer within one year of the date of the filing of his bankruptcy.

The last point raised by Petitioner is that the result below is unduly harsh, and is the product of an erroneous decision by the Court of Appeals. The lower court's findings of extrinsic fraud are well supported by the record.

The Petitioner also questions the decision by the lower court that the purchase of the annuity was actually accomplished post petition, as well as the ruling that the monies taken by the Petitioner on the contingent purchase price payments were assets of the estate. Petitioner raises no conflict issues or other matters that would warrant this Court's review of these issues. These findings are also well supported by the record.

For all of these reasons, certiorari should be denied.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted,

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